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January 31, 2007

***Via Facsimile –
Original to Follow***

Michael Gross, Senior Attorney
National Indian Gaming Commission
1441 L Street, N.W.
Washington, DC 20005

Re: Comments on Proposed Class II Technical Standards

Dear Mr. Gross:

When the National Indian Gaming Commission (the "Commission") chose to extend the comment period on the proposed Class II technical standards, Video Gaming Technologies, Inc. (VGT) saw it as an opportunity to provide valuable input on regulations that will dramatically affect the industry. Over the last two months, VGT has participated in the Technical Standards Working Group (TSWG) – where tribal regulators, tribal gaming operators, game testing laboratories and gaming manufacturers have worked in conjunction with the Commission's staff members and the Commission's Class II Tribal Advisory Committee for Game Classification and Technical Standards (TAC) to develop an alternative set of technical standards for the Commission to consider.

The work was time consuming and expensive. VGT's staff worked with the other participants in marathon conference calls, face-to-face meetings and through literally hundreds of e-mails in which ideas were floated, positions developed and consensus achieved among many competing interests. Weekends and holidays were worked through, and many sacrifices were made by the company's staff to meet the aggressive schedule required by the work. The cost to VGT of participating ran more than one hundred thousand dollars (\$100,000) when considering the travel, meeting costs, and time spent by staff and outside counsel on the project. But, in our view the resulting product was worth the investment.

The TSWG was greatly helped by the input given by both you and the Commission's Chief of Staff, Joe Velandra; and the proposed Class II Technical Standards (standards) submitted to the Commission by the TAC on January 25th are truly historic in what they represent. For the first time in recent history, the Commission staff, regulators, operators, testing labs and even competing manufacturers worked together to develop effective standards that will ensure the integrity of Class II gaming systems, protect tribal customers and their patrons, and preserve tribal assets. While the language was reached

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by consensus, their benefits are concrete and will do much to reinforce the integrity of Class II gaming operations, and create a bright-line distinction between Class II and Class III gaming devices.

VGT is proud of the standards that have come from the TSWG's efforts, and would like to proffer some additional comments to support the document that was created and submitted to the Commission by the TAC during the January 25, 2007 meeting. In this document, VGT will comment in several areas. First, it explains why VGT agreed with the TSWG members and supported the new approach that is the basis of the proposed Standards. Second, it outlines what VGT views as the significant benefits of the Standards – both in terms of the security they provide, and the bright-line they create between Class II and Class III games. And finally, it provides some additional insight on the TSWG's rationale for the “grandfathering” provision in the Standards, language that VGT feels is essential to protect the interests of both Tribes and manufacturers.

As was noted in VGT's September comments, the Commission has undertaken a daunting challenge. The Standards are being developed for an industry that is almost two decades old, and one that – by the Commission's own estimates – will affect more than 50,000 gaming stations in hundreds of locations throughout the United States. To be effective, the Standards have to cover a wide range of potential gaming devices, from bingo minders to the current crop of high-tech Class II games. They have to be flexible enough to deal with older, established technologies, and allow innovation in future Class II products. And, they have to accomplish all of these goals while ensuring the integrity and safety of the Class II gaming system.

VGT feels that the TSWG understood the challenge, and developed rules that address all of these considerations. Everyone in the room focused on the core concerns of integrity and safety – in both the hardware and software – while making sure that all voices were heard. The resulting vetting by regulators, operators, manufacturer's engineers, manufacturer's business staff, testing laboratory staff members and gaming attorneys has much merit, and VGT would encourage the Commission to adopt the resulting document as their Class II Technical Standards.

A Question of Direction

When the Commission initially published technical standards in August of 2006, many commented on the potential affect of the language if implemented. Rather than looking at the Class II game from a “system” perspective, they looked at the individual player terminals instead, and treated them much like slot machines. During public comments at the most recent NIGC meeting with the TAC, Knute Knudson of IGT noted that much of the language was a mix of existing standards in traditional Class III jurisdictions, with some even coming from foreign jurisdictions.

Many of the comments to the initial August draft made suggestions on how to modify the language to better fit Class II gaming; but by the end of the first TSWG meeting in Las

Vegas, it was apparent that such an approach was hopeless – it was trying to fit a round peg into a square hole. The Class III language was problematic for several reasons.

The biggest problem was that the August Draft didn't recognize the essential nature of Class II gaming – the game is in the “system,” not the “box.” Unlike traditional slot machines, in which the “brains” of the game (which determine the outcome) are stored in the box, Class II games cannot be viewed so narrowly. Class II gaming requires competition between linked players for prizes – and today almost all of the Class II games require a central server to “run” the game. “Boxes” only serve as the interface where players communicate with the server – meaning the box simply serves the same role as the bingo paper and bingo dauber in a traditional bingo game.

The August draft also created significant problems for vendors of products like bingo minders because a handheld bingo device is far different than a traditional Class III slot; and with their reliance on the “box,” the August draft blurred the distinction between Class II and Class III at a time when the Commission is trying create a bright-line distinction between the games.

These concerns led VGT to participate in the TSWG, and they are the reasons why the company now asks the Commission to adopt the Standards as submitted by the TAC at the January 25th meeting.

A Class II approach to Technical Standards

Because of the concerns outlined above, TSWG members felt the August draft couldn't be salvaged and went back to the drawing board. Commission Chairman Hogen has often articulated three core principles that the Standards must meet: they must ensure game integrity; they have to protect Tribal Gaming Operations, and they must protect Tribal assets. Using these principles as a guide, several alternative regulations were developed; with TSWG members settling on the draft prepared by Nova Gaming as the basis for its proposal. With thousands of man hours put into amendments, re-writes, tweaks and adjustments; they form the basis for the Standards submitted to the Commission on January 25th.

Working from the ground up, the Standards rely on Class II concepts, with a focus on participation by multiple players. They ensure the integrity of the game, with extensive requirements for Random Number Generators (RNGs),¹ prohibit the use of “reflexive” technology in the Class II gaming system,² demand that that hardware be safe and secure,³ and provide the tools necessary to account for funds at the Tribal gaming operation.⁴ The proposed Standards require that all Class II games be tested,⁵ and that

¹ See Proposed Class II Technical Standards, at 547.14

² See Proposed Class II Technical Standards at 547.8(b)

³ See Proposed Class II Technical Standards at 547.7

⁴ See Proposed Class II Technical Standards at 547.9

⁵ See Proposed Class II Technical Standards at 547.4(a)(1)

Class II Gaming Systems in the field match what has been tested by the lab.⁶ They further require software signatures that can be checked in the field by a Tribal Gaming Regulatory Authority (TGRA) to ensure ongoing compliance,⁷ and establish timelines for testing under normal⁸ and emergency conditions.⁹ In short, they are functional standards that ensure the integrity of the Class II gaming system, that protect the safety of gaming patrons, and that provide the tools needed for accountability. They meet all of the goals articulated by Chairman Hogen.

All of this is achieved in a framework that is uniquely Class II. References to Class III concepts like “jackpots” and “wagers” in the August draft have been replaced with “prizes” and “purchases,” reflecting the bingo-based nature of the gaming systems. The focus has been moved from elements of the system to a focus on the Class II gaming system as a whole, creating a more realistic framework for Class II regulation that is able to regulate the vast range of Class II products from bingo minders, to the current technologically-advanced Class II games, to what will be offered in the future. This flexibility is critical to the future of Class II gaming, but it manages to do so without sacrificing any of the core concepts – integrity, accountability and safety are maintained, no matter the type of Class II Gaming System.

VGT is convinced that this result embodies the best approach for establishing Class II technical standards; and we encourage the Commission to adopt the Standards submitted by the TAC on January 25th.

Establishing a Bright-Line Between the Classes

While not generally the goal of technical regulations, an additional benefit of the Standards is the bright-line it creates between Class II and Class III gaming. At the heart of the distinction is the nature of Class II gaming – competition between players for prizes, as recognized by the Courts applying IGRA. The Standards with their clear focus on the Class II gaming system are premised on the occurrence of that competition.

This focus is significant, and does much to achieve the “bright-line” the Commission desires between Class II and Class III. The Standards do more, however, when read in full. Key in the distinction is the definition of Class II Game in the proposed standard, which refers to the Indian Gaming Regulatory Act.¹⁰ The use of such a definition results in the incorporation of not just the language of IGRA itself, but also the court cases that have interpreted the statutory language. By so doing, the technical standards show that they have a firm statutory definitional base and confirm that their purpose is not overruling judicial decisions by agency rule-making.

⁶ See Proposed Class II Technical Standards at 547.4(a)(3)

⁷ See Proposed Class II Technical Standards at 547.8(f)

⁸ See Proposed Class II Technical Standards at 547.4(b)(1,2)

⁹ See Proposed Class II Technical Standards at 547.4(c)

¹⁰ See Proposed Class II Technical Standards at 547.3, “Class II Game means the same as 25 USC 2703(7)(A).”

By effectively incorporating the established requirements of IGRA, the *MegaMania*,¹¹ *Lucky Tab II*¹² and *Magical Irish*¹³ court opinions, and adding technical standards that not only reflect the nature of Class II gaming but emphasize the Class II Gaming Systems that meet them, the Commission achieves its goal of establishing a bright line between Class II and Class III games. VGT suggests that this is sufficient to meet the Commission's goals; that this achieves a positive outcome for Class II operators and regulators; and that this approach makes further classification standards unnecessary, thereby avoiding expensive, time-consuming litigation on potential equal protection, due-process and *ultra vires* issues, among others.¹⁴

VGT would recommend that the Commission adopt the Standards proposed by the TAC on January 25th, and allow the proposed language to address the Commission's concerns on the Classification issue. Should the Commission decide that further clarification is necessary, VGT would ask that the TSWG be allowed to work with the TAC and Commission to achieve a positive outcome.

While the Commission is anxious to finish its work, Class II classification is clearly an issue that if handled improperly, could have a devastating impact on Native American tribes¹⁵. VGT urges that all stakeholders are best served by a careful consideration of all options. Bad regulations generally, and bad classification regulations in particular, are far worse than none at all.

The Importance of §547.4, 547.8(b) and 547.14

As was noted in the introduction, the Commission is proposing technical standards to regulate an industry that has existed for almost twenty years and that currently operates more than fifty thousand player stations in hundreds of tribal gaming operations throughout the United States. It is an industry that has generated hundreds of millions in revenue for Native American governments, and it is far different than one like asbestos manufacture, where, when it was discovered asbestos causes cancer, demanded immediate regulatory action to protect the safety of Americans.

¹¹ *U.S. v. 162 Mega Mania Gambling Devices*, 23 F.3d 713 (10th Cir. 2000); *U.S. v. 103 Electronic Gambling Devices*, 223 F.3d 1091 (9th Cir. 2000)

¹² *Diamond Game Enterprises, Inc. v. Reno*, 230 F.3d 365 (D.C. Cir. 2000)

¹³ *Seneca-Cayuga Tribe of Oklahoma v. NIGC*, 327 F.3d 1019 (10th Cir. 2003)

¹⁴ If for some reason, the Commission still desires to consider separate classification standards, these proposed technical standards should not serve as an impediment to so doing. By using the IGRA reference in the definition of Class II gaming, and employing that Class II game definition in defining Class II gaming systems, the proposed technical standards clearly articulate the statutory definitional foundation and would do nothing to contradict lawful classification consistent with the language of IGRA and the decisional law applying to it.

¹⁵ See, *The Potential Economic Impact of Proposed Changes to Class II Gaming Regulations*, Alan Meister, PhD., The Analysis Group, November 3, 2006.

Thus, the language in §547.4(b)(3) represents a somewhat historic agreement by the Class II industry. By requiring games already in the field – including many that have been in operation for ten years or more – to meet the requirements of §547.8(b) and §547.14, the industry is agreeing to the immediate application of a rule to a product in the field, without any declaration of emergency. These two sections go to the heart of game integrity, and do much to ensure manufacturers provide Tribal gaming operators – and by extension, tribal gaming patrons – Class II Gaming Systems that are fair.

During testimony on the 25th, the Commission heard that grandfathering was the most contentious part of the drafting process. With so many games already in the field, there are hundreds of millions of dollars invested in them, and determining how to deal with them requires careful consideration. Agreeing to these game integrity software provisions was relatively simple – no one could imagine a Class II game that doesn't meet them; and while confirming that the provisions are met will have some costs, they are reasonable, and are really the only way a TGRA can confirm that the integrity issues are addressed.

Beyond these, the proposed Standards enter a much more difficult realm, one where the requirements are certainly desirable in a “new” game; but where retrofitting an old game would be expensive and result in little benefit since there are other mechanisms already in place that achieve the same goal, and the costs of retrofitting often outweigh the financial return. There are several examples that illustrate the point.

§547.8(e) requires the Class II Gaming System to track vouchers accepted as a category separate from cash accepted; and to be able to recall at least the last five transactions. This is an example of a requirement that, while helpful to the operator, is not essential and that can be determined through other means. Currently, the VGT Live Call Bingo™ platform doesn't differentiate between bills accepted and vouchers accepted; it treats both as a financial instrument with equal value, and means that it cannot currently meet the requirements of §547.8(e). While such a meter might be helpful, it is not something essential to the operation of a gaming facility. This subsection's purpose can be met by the existing software and hardware. Live Call Bingo™ tracks every transaction, meaning there is a complete record of every transaction, this can be compared to the physical drop to determine which is cash and which is a voucher. All voucher acceptances on VGT games occur through interfacing to third party products like IGT's IVS ticket-in/ticket-out solution, and use the third party product for instant voucher verification. This provides an effective check against counterfeit vouchers. Thus, while it requires more labor to research a problem, it is something an operator may be willing to do in the few cases where vouchers are accepted on VGT games. No tribal gaming regulator has objected to VGT's approach. Other than adding convenience, the proposed regulation doesn't dramatically add to the integrity and safety of the game –and adding language to address the requirement would have significant costs.

Not only would software have to be written to create the separate meter; a job that will take several days of programming time, but it would also require a software upgrade at the casino; requiring an upgrade to the Live Call Bingo™ server and to the software on each of the player terminals. On a typical upgrade of this sort, it will take four VGT employees 6-8 hours to upgrade 250 games. To upgrade all of VGT's games in the field will cost in the neighborhood of \$200,000;¹⁶ and it only addresses VGT's costs. In addition, the tribal gaming operator will have to tie up security and surveillance personnel to oversee the upgrade; and most TGRAs will also have staff on site during the upgrade; resulting in a significant investment for a change of convenience.

A second example of a Standard that will create little benefit yet require a significant investment is §547.7(a)(2), which requires UL certification of the Class II gaming System. Underwriters Laboratories (UL) certification is essentially a "seal of approval" that provides comfort to consumers about the safety of a product. It is issued only after UL has tested the product, but it is not a guarantee of safety – it simply means that the product passed their testing.¹⁷ Submission is done on a voluntary basis, and there are no National laws requiring UL certification of gaming products in general or Class II gaming in particular. Rather, it is up to the individual municipalities and states to establish the requirement for this sort of testing.¹⁸ To date, there are few if any Class II jurisdictions that require UL certification, and because of it there are many manufacturers who haven't gone to the expense of UL certification.

That doesn't mean that the 55,000 games in the field are dangerous. VGT's games use nothing but UL certified parts, from the power supplies, to the computers, to the monitors and lights – even the cabling in the games is UL certified. A manufacturer who builds devices for many other gaming companies constructs VGT's games. The games are built to established industry standards. VGT is unaware of any problems resulting from a design defect like what would be identified by UL testing. Based on the components and manufacturing process, the existing VGT games are almost certain to pass UL testing – meaning all they are missing is the sticker.

It will be relatively simple for VGT to certify new games; but the more than 13,000 in the field represent a significant problem. The options are to replace the games with an essentially identical UL certified game – which is simply cost prohibitive,¹⁹ or to use the UL field-testing program to certify the existing games. While still expensive, it is far less so than building new games.²⁰ Yet field-testing brings its own unique problems.

¹⁶ This includes the cost of software development, lab testing, software deployment (disks, etc) and labor on the upgrade

¹⁷ See UL.com, section on Frequently Asked Questions (FAQ)

¹⁸ Id.

¹⁹ At an estimated \$6,000 per game, it would result in a staggering bill of \$78 million dollars.

²⁰ VGT has initiated discussions with UL on what it would require to obtain field-testing. Since it approves by model, there are many variables in measuring the actual cost. The initial discussion contemplated testing one (1) model with a total of 13,000 games; and the best-case estimate was \$1.5 - \$2 million.

Essentially every game in the field will have to be touched by UL personnel, a task that, under optimal situations, UL estimates will take 300 days.²¹ The Commission should recognize, however, that this situation is not optimal. In addition to the UL personnel, VGT staff will need to be present, as will Casino security and surveillance personnel and in many cases, TGRA staff. The costs of the VGT, casino and TGRA staff are above the UL certification fee, and the need to work around the TGRA and Casino schedules will likely add dramatically to the timeline. Much like the software example, requiring UL certification of games already in the field will have a dramatic financial impact on manufacturers and Tribes, yet do little to improve the safety and security of games already in the field.

VGT's review of the other provisions found similar results. In every case where the proposed standards are not met by games already in play at Tribal gaming facilities, another method existed to achieve the goal of the proposed regulations. With surveillance, security, Minimum Internal Control Standards, internal audit departments, financial accounting packages and all of the other support found in today's Class II gaming operations, there are already tools in place to ensure the integrity of the gaming operation, to account for the revenues and to protect the safety of Tribal assets and gaming patrons. And the regulations require the reporting of games in play (or ready for play) at the time the regulation goes into effect, so caps on the number of games can be grandfathered. Because of this, VGT feels that the Grandfathering provision, as worded in the proposed Standards is effective, and should be implemented as submitted.

There was some discussion during the meeting on January 25th about a need to put a time limit on the changes, and require every game to come into full compliance by some set time; but it is VGT's position that such a requirement is unnecessary. The fact that it has taken almost twenty years to develop these standards makes it clear there is not an emergency requiring immediate attention. It is also clear that market forces will deal with the issue, as Tribal gaming operators and their customers demand new features and titles.

Legal reasons provide additional support for the grandfathering provisions. By treating all existing games equally as to technical standards, the proposed technical standards avoid any equal protection infirmity. Further, by grandfathering the existing games, the commission is relieved of the need to complete an evidentiary record sufficient to overcome due process and arbitrary and capricious challenges. VGT believes that compilation of such a record would be very difficult, if not impossible.

Section 547(b)(2) allows manufacturers a year to bring new games and their components into compliance with the new standards. This provision is significant, as it ensures there

Further research indicates VGT has six (6) different models to test, so the cost is probably in the range of \$3 - \$5 million, accounting for the savings associated with fewer games in each model group.

²¹ This timeline is a best-case scenario. In the unlikely event some problem is identified, the timeline could be significantly longer.

is no “technology freeze” that prevents Tribal gaming operators from placing new games while manufacturers work to bring their platforms into compliance with the new regulations. Witnesses testified in the hearing on January 25th that there were no Class II games that met all of the requirements of the proposed standards, meaning every manufacturer will have to perform work to come into compliance. In manufacturing new games, VGT will be required to change its existing Live Call Bingo™ software platform. These changes will then have to be tested to ensure compliance with the proposed standards. With such a burden being placed on all manufacturers, and the limited number of test laboratories available to certify Class II games under the proposed Standards, the one year period to come into compliance is a reasonable request, and one that VGT hopes the Commission will support.

The situation is analogous to the much more serious situation of air bags on automobiles. Car manufacturers were required to install air bags on all vehicles they manufactured beginning in the early 1990’s because of their inherent safety benefits. But, even though they added to the safety of passengers, the government only required their installation in new vehicles. There are, to this day, millions of cars still in use that do not have airbags. Thus, the company asks that the Commission accept the grandfathering language in §547.4(b)(3) of the Standards.

An Emphasis on Minimum

While some may argue that additional restrictions need to be added, VGT asks that the Commission remember these are minimum standards. Many operators will demand features beyond the ones established in the Proposed Standards. Likewise, Tribal Gaming Regulators are clearly free to do so. That said, there are many small Class II gaming operations spread throughout the United States. Locations with 15-100 games, many are located in difficult to reach rural areas, with less than optimal gaming markets. At these locations, the revenue per game is often quite low, where the Tribal gaming operator struggles to generate a profit each month. These locations are like small locals casinos in Nevada, where you almost never see ticket-in/ticket-out systems or player’s clubs. The revenue at these locations doesn’t justify the expenditure; and if the added features were required at these less profitable locals properties, many would be forced to close because they simply cannot afford such an extravagant cost.²² Should the Commission add too many requirements to the Class II gaming system, Tribes will find themselves unable to operate these small, less profitable Class II gaming facilities – with harsh economic consequences to their people.

These smaller facilities are often significant employers of Tribal members, and provide unique opportunities for rural residents. They are truly the backbone of rural Tribal industry, and in VGT’s opinion, they are one of the best reasons to allow Class II gaming. Much attention should be given to the economic impact of any additional requirements

²² Based on prevailing industry rates, player tracking and cashless transaction systems for a 100 machine property can run anywhere from \$450,000 to more than \$2,500,000.

the Commission might consider, to ensure that these smaller operations are not damaged by these efforts.

Conclusion

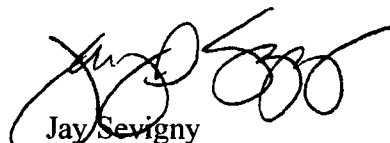
As was noted earlier, the Commission has undertaken a difficult task – implementing technical standards for the Class II gaming industry. Working with an established industry is difficult, especially one as old and with the economic impact of Class II.

The Commission's willingness to extend the process and allow additional commentary is appreciated. It gave VGT, and all of the Class II industry, the unique opportunity to work with your staff to develop regulations that are effective, that ensure the integrity of existing and future Class II gaming systems, that protect the Native American tribes and their customers, that establish a bright line between Class II and Class III, and that effectively deal with the issue of the more than 50,000 games already in the field. The result of those efforts is the proposed Standards submitted to the Commission by the TAC on January 25th.

The more they are reviewed, the more apparent is the thought that went into each provision. The TSWG process produced conflict, and every single provision of the document received a full and thorough vetting among the tribal leaders, tribal gaming operators, tribal gaming regulators, attorneys and manufacturers who participated in the process. From that conflict came a document that is remarkable for its content and the substantial agreement it has generated. The members of the TSWG are rightfully proud of the document, and most left with the hope that the process will form a new mechanism for the Commission to deal with future issues. VGT certainly thinks the results support using the process in the future, as the consensus-building that occurred resulted in far better standards than any one group could have produced on their own. Thank you for allowing the TSWG to submit its proposal.

VGT appreciates this opportunity to participate in the Class II Technical Standards comment process, and stands ready to provide additional information and assistance. Should you have any questions, or need any further information, please feel free to contact me at (615) 220-9312.

Sincerely,



Jay Sevigny
Chief Operating Officer